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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13–19) is reported in 34 B. T. A. 145. The opinion of the Circuit Court of Appeals (R. 36–41) is reported in 89 F. (2d) 711.

JURISDICTION

The decree of the Circuit Court of Appeals was entered April 8, 1937. (R. 42.) The petition for a writ of certiorari was filed June 2, 1937, and was granted October 11, 1937. (R. 43.) The jurisdic-

tion of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether cash received in a statutory reorganization by petitioner, and turned over to its stockholders in consideration of their assumption and payment of petitioner's debts, must be regarded as "distributed" in pursuance of the plan of reorganization, within the meaning of Section 112 (d) (1) of the Revenue Act of 1928, thus relieving from taxation to petitioner the gain included therein.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 27–32.

STATEMENT

The stipulated facts show that petitioner formed or caused to be formed on July 14, 1928, the Peterson Investment Company and transferred to it certain assets in exchange for the entire capital stock of the latter, which was immediately distributed to the stockholders of petitioner (R. 8, 36). Subsequently, on August 23, 1928, petitioner transferred all its remaining assets to Grand Union Company for 18,000 shares of Grand Union Company stock and $426,842.52 in cash. (R. 8, 14.) In the transfer to or exchange with Grand Union Company, petitioner was committed, by a resolution adopted the previous day, immediately to turn

over to its stockholders, who were three in number, the cash it received in the exchange. The resolution is as follows (R. 8–9, 14, 31):

> Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent.

The money was turned over by petitioner to its three stockholders. Its corporate debts amounted

to $106,471.73. The evidence does not contain the written agreement required by the resolution, but it is stipulated that the amount of the liabilities was assumed and discharged by the shareholders (R. 14). The stockholders themselves were creditors of petitioner in the aggregate sum of $6,524.10 and these debts were paid by means of the stockholders retaining out of the first cash received the respective amounts due them (R. 9).

The Commissioner determined that cash received by petitioner in a statutory reorganization in the sum of $426,842.52, and immediately distributed to its stockholders, was, to the extent of $106,471.73, a distribution for the benefit of creditors, since the stockholders were required to pay corporate debts in that amount; and therefore that the cash was, to that extent, not distributed in pursuance of the plan of reorganization within the meaning of Section 112 (d) (1), Revenue Act of 1928. The Commissioner accordingly included the sum of $106,471.73 as profit on disposition of assets and computed the tax on that basis (R. 10–12).

Upon its first consideration of the stipulated facts of this case the Board of Tax Appeals held, in *Minnesota Tea Co.* v. *Commissioner,* 28 B. T. A. 591, that there was no statutory reorganization, and that therefore a consideration of the taxpayer's contest of the Commissioner's original determination of deficiency was precluded. Upon appeal by the taxpayer, petitioner herein, the Circuit Court of Appeals for the Eighth Circuit held, in

Minnesota Tea Co. v. *Commissioner,* 76 F. (2d) 797, that a statutory reorganization had been effected within the meaning of Section 112 (i) (1) (A) of the Revenue Act of 1928, reversed the decision of the Board, and remanded the case for consideration of the original issue. The decision of the Circuit Court of Appeals was affirmed by this Court in *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378 (R. 13–14).

The Board of Tax Appeals on its second consideration of the case held that the provisions of the resolution with respect to distribution of cash by petitioner and the agreement by the stockholders to assume the debts were not conditioned upon each other, that there was an express distribution of all the cash among the shareholders within the literal language of the statute, that the dominating purpose of the reorganization provisions of the statute is elusive, and, upon these grounds, reversed the determination of the Commissioner. (R. 15–18.) In a dissent, six members of the Board expressed the opinion that the distribution was expressly conditioned upon the assumption of the corporate debts by the stockholders and that they took the distribution subject to this condition. The minority also felt that this transaction, for tax purposes, was not essentially different from a situation where the corporation had discharged its debts directly with cash received in a reorganization. (R. 18–19.)

The Circuit Court of Appeals reversed the Board. Construing the resolution under which the cash received in the statutory reorganization was distributed to the stockholders, the court held that "the payment of this indebtedness by the stockholders was a condition attached to and governing the distribution;" further, that petitioner "received the full benefit of this payment to the same extent as though it had retained that amount from distribution and applied it to payment of such indebtedness; * * *." (R. 40–41.) Accordingly, it concluded that there was not a genuine distribution of the sum of $106,471.73, but rather a circuitous retention and application thereof by petitioner. The case was ordered remanded to the Board for a determination of the gain in accordance with the opinion (R. 41).[1]

SUMMARY OF ARGUMENT

The scheme of the reorganization statute (Section 112, Revenue Act of 1928, *infra*) is not to permit the gain received from exchanges included therein to go unrecognized both to the corporation and its stockholders. In cases of stock and

[1] The basis of the assets transferred by petitioner to the Grand Union Company was $199,016.09 (R. 12). It appears, therefore, that since petitioner recovered more than this sum in the cash payment received of $426,842.52, the entire amount of $106,471.73, the total of corporate debts paid, is includable in petitioner's gross income for the taxable year.

securities received and held or distributed by the corporation there is a mere postponement of the tax thereon until a final disposition. Section 112 (b) (4) and (c). In cases of cash or other property received the gain realized by the corporation, not in excess of the sum of such money and the fair market value of such other property, is taxable to the corporation unless distributed by it in pursuance of the plan of reorganization. Section 112 (d) (1) and (2). The reason for not recognizing the gain to the corporation when so distributed is that its stockholders will pay a tax on the income thus received. Section 112 (c). The Board and the courts have uniformly held that a distribution by a corporation to its own creditors is not a distribution within the intendment of the statute.

Since it is apparent here that the distribution to the stockholders, to the extent they were required to pay corporate debts ($106,471.73), was not taxable to them, the gain realized by the corporation in that amount would escape taxation if it were treated as distributed in pursuance of the plan of reorganization. Accordingly, we submit, the conclusion below is in harmony with the purpose and intent of the reorganization statute; with the rule that the payment of an obligation by another is income to the one whose debt is liquidated; and with the principle that a taxpayer claiming an exemption must bring himself squarely within the intent as well as the language under which the exemption is claimed.

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Since this Court's decision in *Gregory* v. *Helvering,* 293 U. S. 465, the rule has been well settled that a mere literal compliance with the reorganization provisions will not render a gain, otherwise taxable, unrecognizable under that statute. Accordingly, it will not suffice for the petitioner here to point to a literal distribution to stockholders as that "which the statute intended."

The authorities relied upon by petitioner are not controlling in the instant case since they do not decide the question presented by the facts here involved.

ARGUMENT

THE TRANSFER OF CASH TO A CORPORATION'S STOCKHOLDERS UPON CONDITION THAT THE STOCKHOLDERS ASSUME PAYMENT OF THE CORPORATION'S DEBTS IN IDENTICAL AMOUNT, WHICH DEBTS ARE ACCORDINGLY ASSUMED AND PAID BY THE STOCKHOLDERS, IS NOT A "DISTRIBUTION" WITHIN THE MEANING OF SECTION 112 (D) OF THE REVENUE ACT OF 1928

Petitioner, in a statutory reorganization, exchanged its assets for Grand Union Company stock and $426,842.52 in cash. The stock was retained and the cash transferred to petitioner's stockholders. The stockholders agreed to assume payment of petitioner's debts amounting to $106,471.73, and did so pay them.

Section 112 (d) (1) and (2) of the Revenue Act of 1928, *infra,* provides that if the corporation

receiving money in a statutory reorganization "distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but * * * If the corporation receiving such * * * money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, * * *." The Commissioner did not seek to tax petitioner for the gain represented by the excess of $426,842.52 over $106,471.73, and the question in this case involves only the latter amount. Was the sum of $106,471.73 "distributed" by petitioner to its stockholders within the meaning of Section 112 (d) of the Revenue Act so as to exempt petitioner from taxation on the gain realized by the receipt of that sum upon the exchange of its assets? We submit that it was not so distributed.

First, there can be little question that the transfer of cash to the stockholders was expressly conditioned upon their assumption of payment of petitioner's debts. The resolution adopted at the stockholders' meeting which authorized the exchange of petitioner's assets stated (R. 31):

> Resolved further that all moneys received * * * shall be immediately distributed to the stockholders * * * *upon the assumption* by the stockholders of all the corporate debts * * *[2]

[2] Unless otherwise noted, all italics used herein are ours.

The resolution accordingly directed the board of directors "to distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders * * * whereby *said stockholders,* in consideration of such distribution * * *, *agree to pay* all the corporate debts of Minnesota Tea Company * * *"

The Board, treating the provision for "distribution" to the stockholders as independent of the provision for the stockholder's agreement to pay the corporate debts, intimated that the transfer was not conditioned upon the stockholders' assumption of debts (R. 15). But the two provisions are part of the same sentence, separated only by a comma. A dividend resolution "is to be taken as it emanates from the Board. A part of it cannot be taken and the rest discarded." *State* v. *Balt. & Ohio R. R. Co.*, 6 Gill (Md.) 363, 386. By the inseparable, express statement of the resolution, distribution was to be made to the stockholders "upon the assumption by the stockholders of all the corporate debts." And we believe it clear, as the court below held (R. 40–41) that "the payment of this indebtedness by the stockholders was a condition attached to and governing the distribution."

In any event, it cannot be disputed that upon receipt of $106,471.73 the stockholders immediately became obligated to pay corporate debts in like amount. It cannot be reasonably said that they re-

ceived any income from the receipt of that sum. This is particularly emphasized by the fact that corporate debts owing to petitioner's stockholders (R. 9) were of course immediately extinguished upon the transfer of cash to the stockholders. The stockholders could not be taxed on the sum received in payment of petitioner's debts. See R. 11. Petitioner contends nevertheless that the transfer of the cash resulted in an exemption to it from tax upon the gain realized upon the receipt of cash in the reorganization. The contention is contrary to the plain intent and purpose of the reorganization provisions immediately to tax gains realized in cash either to the corporation or to its stockholders.

The reorganization provisions do not permit gains resulting from transfers of stock or properties to go untaxed in the hands of the corporation and its stockholders. In the case of stock and securities received and held or distributed by the corporation there is a mere postponement of tax on the gain on the exchange until there is a final disposition of the stock and securities.[3] But the gain represented by cash or other property, so called "boot", is immediately taxable. Section 112 (c) (d), *infra;* see H. Rep. No. 179, 68th Cong.,

[3] See quotation in petitioner's brief, pp. 6–7, from Report of House Ways and Means Committee, 1924, when the pertinent provisions of the reorganization statute were revised and adopted. H. Rep. No. 179, 68th Cong., 1st Sess., pp. 16–17.

1st Sess., pp. 14–15; S. Rep. No. 398, 68th Cong., 1st Sess., pp. 15–16. Cash or other property received by the corporation is expressly taxed to it unless distributed "in pursuance of the plan of reorganization." Section 112 (d). If the cash is so distributed, the corporation pays no tax thereon, but the cash is taxable to the distributee stockholders under the explicit language of Section 112 (c). That provision deals with the distributee and prescribes the manner in which he shall account for his share of the distribution. In his hands it is taxed in one of two ways: (1) The portion which represents the distributive share of the corporate earnings since February 28, 1913, is taxed as a dividend (except in the rare case where the distribution does not have "the effect of the distribution of a taxable dividend," as, for example, in cases under Section 104 (d) of the Revenue Act of 1928); and (2) the balance is taxed as gain upon an exchange. If it is deemed that Section 112 (c) is not applicable to cash distributed to stockholders in an exchange under Section 112 (b) (4), nevertheless such receipt of cash is taxable to stockholders under the general income provisions of Section 22 (a). This is clearly so since Section 112 (d) provides an exemption for the *corporation* if cash is distributed, but neither in Section 112 (d) nor in any other section of the Act is there a provision exempting stockholders from taxation upon

cash distributed to them by the corporation under Section 112 (d).

Here the stockholders could not be taxed,[4] and upon petitioner's theory the gain realized in cash would be taxable neither to the corporation nor the stockholders. But Congress was interested in relieving the corporation from tax only if the stockholders were to be subject to a tax instead. A construction of the statute which results in an exemption from tax by both appears inadmissible.

It would seem that the term "distributes" in Section 112 (d) is used in the same sense as in Section 115 (a). There the term "dividend" is defined as "any distribution made by a corporation to its shareholders * * *". When, as here, "distributes" is applied to a corporation, it can only mean a distribution to stockholders, in their capacity as stockholders, for their own separate use and benefit. Cf *Eisner* v. *Macomber*, 252 U. S. 189, 207, 211.

The committee reports are clear on this point. Section 112 (d) was first included in the Revenue Act of 1924, c. 234, 43 Stat. 253, as Section 203 (e). H. Rep. No. 179, *supra*, states (p. 15):

> SECTION 203 (e): There is no provision of the existing law which corresponds to subdivision (e) of the bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization trans-

[4] See p. 11, *supra*.

> fers its assets to another corporation, a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss to the transferor is recognized, if it distributes the cash *to its stockholders*. But if the selling corporation fails to distribute the cash *to its stockholders* then the gain or loss is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a *conduit* in passing the proceeds of the sale on *to its stockholders*, no gain to the corporation is to be recognized, but if it retains all or any of the proceeds with the result that the transaction is in substance a real sale, then all or a part of the gain shall be recognized.

The same explanation is found in the report of the Senate Committee on Finance (S. Rep. No. 398, 68th Cong., 1st Sess., p. 16). Here it cannot be said in any substantial sense that petitioner acted "merely as a conduit in passing the proceeds of the sale on to its stockholders;" or that petitioner "distributed" the cash in contradistinction to "retaining" it. The transfer of cash in the amount of $106,471.73 can not be treated separately from and independently of the condition, or at least the concurrent obligation, to pay corporate debts in equivalent amount. Viewed realistically, as principles of tax law and administration require, they were component parts of a single transaction designed to effect a single purpose—the payment of corporate debts. It is well settled that, for income tax pur-

poses, such "component steps of a single transaction cannot be treated separately." *Bassick* v. *Commissioner,* 85 F. (2d) 8, 10 (C. C. A. 2d), certiorari denied, 299 U. S. 592; *Starr* v. *Commissioner,* 82 F. (2d) 964 (C. C. A. 4th), certiorari denied, 298 U. S. 680; *First Seattle D. H. Nat. Bank* v. *Commissioner,* 77 F. (2d) 45, 48–49 (C. C. A. 9th); *West Texas Refining & D. Co.* v. *Commissioner,* 68 F. (2d) 77, 80 (C. C. A. 10th).

Indeed the stockholders acted as a conduit for the corporation in paying its creditors. The transaction does not differ in substance from a direct distribution by petitioner to its creditors in payment of its debts. As to debts owed to the stockholders, the transaction was even in form a direct distribution to creditors. There is no rational distinction between payment of the debts owed to petitioner's stockholders and payment of the debts owed to other creditors. But the statute means a distribution to stockholders, not to creditors; and the statute neither intends nor operates to transfer the tax due from the corporation to persons other than stockholders. H. Rep. No. 179, *supra;* S. Rep. No. 398, *supra.* The Board of Tax Appeals has so held. *Liquidating Co.* v. *Commissioner,* 33 B. T. A. 1173; cf. *Bancker* v. *Commissioner,* 31 B. T. A. 14. The same construction of the statute was adopted and applied by the Tenth Circuit Court of Appeals in *West Texas Refining and D. Co.* v. *Commissioner, supra.*

Moreover, the payment of a debtor's obligation by another results in income to the debtor. *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716; *United States* v. *Boston & M. R. Co.*, 279 U. S. 732; *Douglas* v. *Willcuts*, 296 U. S. 1. Assuming that the transfer to the stockholders is to be treated as a "distribution" within the meaning of the statute, it is clear that the payment of the corporate debts by the stockholders would result in a taxable gain of a different character to the corporation. Therefore, if petitioner's argument should prevail, petitioner escaped the tax upon the gain realized from the exchange, but as soon as the stockholders paid the corporate debts petitioner should have been chargeable with the receipt of income in the amount of cash so used. Such circumlocution could not have been intended by Congress. It would be pointless to decree an exemption upon the distribution for payment of corporate debts if the corporation would be subjected to tax, as soon as the cash distributed were so used.

As a matter of fact, in such a case the corporation might be subject to a larger tax than that for which it would have been liable if the transfer were held not to be a distribution within the meaning of the statute. Where a corporation retains the cash it is taxable only to the extent that the cash represents the gain upon the exchange. Section 112 (d) (2). That tax is imposed upon the gain realized from the transfer of its assets. Thus in

this case the $106,471.73 cash is taxable upon the Government's theory because the gain to the petitioner from the transfer of its assets was in excess of that amount. But if the transfer to the stockholders in such a case as this be treated as a distribution, then the subsequent payment of the corporate debts in the amount of $106,000 will represent income to the corporation in the amount of $106,000 irrespective of whether the corporation realized that much gain upon the exchange. For example, if petitioner's entire profit upon the transfer of its assets in this case had amounted to only $75,000, and the transfer of $106,000 to petitioner's stockholders be held to be a distribution, the result would be an avoidance by petitioner of a tax upon $75,000. However, if the stockholders then used the $106,000 to pay the corporate debts, the entire $106,000 would be chargeable to petitioner as taxable income.

Since the gain upon the transfer of its assets is the only gain with which Congress dealt in the reorganization statutes, there is no room for the contention that the income resulting from the payment of the corporate debts by the stockholders was also intended to be exempted. That would be a true exemption—a permanent exemption—and not the postponement or temporary exemption of tax which was intended by Congress in the reorganization statutes. H. Rep. No. 179, 68th Cong., 1st Sess., p. 16; S. Rep. No. 398, 68th Cong., 1st Sess., p. 17.

From the foregoing it appears that the acceptance of petitioner's argument means: (1) That Congress has exempted from tax the cash gain upon the exchange because it was "distributed" to the stockholders; (2) that Congress has immediately imposed a tax upon the corporation because the stockholders have discharged the corporate debts; and (3) that the second tax may in some cases be larger than the tax which was escaped. This is utterly illogical and petitioner's argument should be rejected. No such curious result flows from the adoption of the Government's contention. We submit there was no "distribution" in the substantial sense intended by Congress.

In seeking a reversal of the decision below petitioner asserts a literal compliance with Section 112 (d) (1), *infra,* since there was a physical transfer of the sum of $106,471.73 to its stockholders. It is argued from this that it is the Commissioner who seeks to depart from a recognition of the actual distribution and thus the burden is upon the Government to establish the taxability of the item in question. Such an argument, in the first place, ignores the well established rule that a mere literal compliance with the reorganization provisions will not suffice to obtain the benefits therein provided. *Gregory* v. *Helvering,* 293 U. S. 465, 469. In the second place, the argument fails to recognize that under the general rule of the reorganization statute (Section 112 (a), *infra*), the entire amount of the gain is taxable to the corporation and only in so

far as the transaction comes within one of the exceptions enumerated therein may the tax liability of the corporation be postponed or passed on to its stockholders. Since the petitioner here is claiming the benefit of one of these exceptions (Section 112 (d) (1), *infra*), there can be no doubt but that it must bring itself squarely within the intent as well as the language under which the benefit is claimed. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Gregory* v. *Helvering, supra.*

Like the inquiry in the *Gregory* case, the question here is whether the pertinent transaction, even if it were literally in accord with the statutory language, "was the thing which the statute intended." In that case it was earnestly contended on behalf of the taxpayer that since every element required by the statutory definition of reorganization contained in subdivision (B) of Section 112 (i) (1), *infra,* was present, the exchange there involved necessarily fell within the statutory scope. This Court, looking through the form of the transaction and giving effect to the real purpose as well as the result actually accomplished by the transfer, held (p. 470):

> In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), ***was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization,*** and nothing else. The rule which excludes from con-

> sideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. [Italics supplied.]

So, we say, in the instant case the distribution here, to the extent that the stockholders were required to pay the corporate debts, was a distribution, *pro tanto,* for the benefit of creditors; not a true distribution within the intendment of the statute. It may be taken to be *in fact an elaborate and devious form of conveyance masquerading,* in part, as a distribution to the stockholders. In order to constitute a true distribution, as demonstrated above, the distribution under Section 112 (d) (1) must result in income to the stockholders—something acquired by the stockholders for their own separate use and disposal. Such is not the result where the distribution carries a legal obligation to pay the corporate debts. Since the statute does not intend or provide that the cash shall go tax free to both the corporation and its stockholders, it follows that a distribution in form, but not in reality, is not sufficient to bring the transaction within the statute.

In this Court petitioner mainly relies upon the case of *United States* v. *Hendler*, 91 F. (2d) 680 (C. C. A. 4th), now pending on ~~petition for a~~ writ

of certiorari, No. 563, October Term, 1937. There, the Hendler Company in 1929 transferred all its assets to the Borden Company in exchange for 105,306 shares of the latter's capital stock, $43,-421.87 in cash, and assumption by Borden of all of Hendler's indebtedness. The Commissioner treated the transaction as a statutory reorganization and since the stock and cash had been immediately distributed by Hendler to its stockholders any gain thereon was treated as nonrecognizable to the corporation under the provisions of Section 112 (d) (1). The Commissioner, however, did assess to the Hendler Company and collect from its transferee a tax based upon the gain to Hendler represented by the assumption and discharge by Borden of a first mortgage bond issue of Hendler in the sum of $534,297.40.

Although expressly recognizing the rule that the payment of an obligation of a taxpayer by another person constitutes income to the taxpayer, the Fourth Circuit Court of Appeals held that if such assumption and discharge were made in connection with a statutory reorganization, no gain then was recognizable to the corporation whose debts were paid. While the basis of the decision is not entirely plain from the opinion, the court, in part, holds that the transferor in a reorganization agreement receives nothing from the assumption of its debts by the transferee that prevents it from claiming an exemption under either of the cited subsec-

tions (Section 112 (b) (4) and (d)) of the statute. Further, the court held that the price paid for the corporate assets by the transferee includes both the value which passes to the corporation or its stockholders and that which passes to its creditors; and that the entire profit will be recognized when upon the ultimate liquidation of the assets actually received by the corporation or its stockholders a comparison is made between that which was originally put into the venture and that which has been finally taken out.

This construction and application of the reorganization provisions, we believe, is contrary to the fundamental aim of the statute that no gain shall escape taxation and that only to the extent provided by Section 112 (d) will the cash or other property received by a transferor corporation not be recognized, the reason for such non-recognition being that if such property be distributed to its stockholders, they in turn will be liable for a tax thereon under Section 112 (c), or Section 22 (a)

Petitioner (Br. 11) sets forth various situations in which the debts of the transferor corporation are discharged in connection with a reorganization and urges that in all cases the tax result should be the same. The four situations suggested are: (1) The transferee pays the transferor only the net worth of the assets transferred and assumes payment of the transferor's debts (the *Hendler* case); (2) the transferor pays its debts before the

transfer is made; (3) the transferor pays its debts out of cash received from the transferee; and (4) the transferor conveys the cash received from the transferee to the transferor's stockholders and requires the stockholders to pay its debts (the present case).

Situation (2) involves a transfer of net assets only. In such a case no cash received as a consideration is used to pay debts and the question here presented under Section 112 (d) obviously cannot arise. (3) and (4) are alike in that the cash consideration is used to pay the corporate debts. It is our view that in either of those cases the corporation would be taxable under Section 112 (d) (2). In situation (1) (the *Hendler* case), we consider that there has been a constructive re-receipt of cash, and hence believe that the corporation would be likewise taxable. Thus the Government's theory is wholly consistent, and every comparable situation is treated uniformly.[5]

The *Hendler* decision reaches a result inconsistent with other comparable situations, which demonstrates, we believe, that the decision is erroneous. For example, if petitioner had used $106,000 of the total amount of cash received from the transferee and directly paid its debts (situation (3))

[5] There appear to be no published rulings on either the question here involved or on the question involved in the *Hendler* case. The Commissioner's action in the few cases in the Bureau of Internal Revenue which have presented similar questions has been in accord with his determination both in the *Hendler* case and here.

there could have been little question that petitioner would have been taxable upon gain in that amount (see pp. 13–15, *supra*). Petitioner's reliance upon the *Hendler* decision is then curiously inconsistent with its contention that a like tax should result in similar cases.

Regardless, however, of the ultimate result in the *Hendler* case, we submit that cash received by a corporation and not actually distributed to its stockholders so as to result in a tax on them is not a true "distribution" within the intendment of that term as used in Section 112 (d) (1).

As pointed out by the petitioner, *United States* v. *Hendler, supra,* is the only case which has directly passed upon the question of the effect of assumption and discharge of indebtedness of the transferor by the transferee corporation. Accordingly, *G. & K. Mfg. Co.* v. *Commissioner,* 296 U. S. 389, and the other cases cited at page 12 of petitioner's brief, are not persuasive, since the question was neither raised nor decided therein. "Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents." *Webster* v. *Fall,* 266 U. S. 507, 511; *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378, 380.

Finally, petitioner maintains (Br. 16) that it is not a sufficient answer to say that in this case the tax must be imposed, otherwise the gain will escape

taxation. We think that it is. Assuming that there is no intent in the reorganization statute to exempt the realized gain both to the corporation and its stockholders, no plausible reason has been suggested by the petitioner why such a result should be reached in the instant case. While seeking the legislative grace to be found in Section 112 (d) (1), petitioner has not plainly established its right thereto. This Court has remarked that a well founded doubt is fatal to such a claim. *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146; see *Gregory* v. *Helvering, supra; New Colonial Co.* v. *Helvering, supra.*

CONCLUSION

For the foregoing reasons, we respectfully submit the decision of the court below should be affirmed.

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DECEMBER 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no

gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in

identity, form, or place of organization, however effected.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the

part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

Treasury Regulations 74:

ART. 575. *Exchanges in reorganizations for stock or securities and other property or money.*—If stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged for stock or securities in such corporation or in another corporation a party to the reorganization and other property or money, the gain, if any, to the recipient will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized. (See section 112 (e).) If a distribution of property or money in the course of a reorganization is otherwise within the provisions of this paragraph, but has the effect of the distribution of a taxable dividend, there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized under this paragraph as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain recognized under this paragraph.

* * * * *

If, in pursuance of a plan of reorganization, property is exchanged by a corporation

a party to a reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized. (See section 112 (e).)

U. S. GOVERNMENT PRINTING OFFICE: 1937

SUPREME COURT OF THE UNITED STATES.

No. 106.—October Term, 1937.

Minnesota Tea Company, Petitioner, *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit

[January 17, 1938.]

Mr. Justice Sutherland delivered the opinion of the Court.

Petitioner, in 1928, brought about the organization of the Peterson Investment Company, and transferred to it certain assets in exchange for the entire capital stock of that company. The stock was immediately distributed to petitioner's stockholders. Soon thereafter, petitioner transferred its remaining assets to Grand Union Company in exchange for 18,000 shares of that company's stock and $426,842.52 in cash. The cash was immediately transferred to and divided among petitioner's stockholders, in proportion to their stock holdings, in pursuance of a plan of reorganization. The Board of Tax Appeals, upon its first consideration of the case, held that no reorganization had been effected under § 112 (i) (1) (B) of the Revenue Act of 1928. 28 B. T. A. 591. The Circuit Court of Appeals concluded otherwise, reversed the Board, and remanded the case to the Board for further consideration. 76 F. (2d) 797. Upon review, pursuant to a writ of certiorari, we affirmed the judgment of the Circuit Court of Appeals. *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378.

Upon the remand, the Board, after consideration, refused to follow the ruling of the commissioner that $106,471.73 of the $426,842.52 constituted taxable assets in the hands of petitioner. 34 B. T. A. 145. The court below, reversing the action of the Board, sustained the view of the commissioner, 89 F. (2d) 711; and the case again comes here upon writ of certiorari. 302 U. S. —.

The facts are not in dispute. In addition to those already stated, it appears that immediately before the receipt by petitioner of the $426,842.52, its stockholders, at a special meeting, adopted the following resolution:

"Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof,

whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent."

When the cash was "distributed", petitioner's debts amounted to $106,471.73, about $6,500 of which was owing to the stockholders themselves. In pursuance of the resolution, the stockholders paid all the debts, retaining sums, aggregating about $6,500, necessary to discharge the amount of petitioner's indebtedness to them.

The question for determination is whether the delivery of the $106,471.73 by petitioner to the stockholders, an equal sum thereafter being applied by them to the payment of petitioner's debts in pursuance of the resolution, constituted a distribution within the meaning of the provisions of § 112 (d) (1) and (2) of the Revenue Act of 1928, copied in the margin.[1]

These provisions plainly establish that, in respect of any cash received and not "distributed", there was a taxable gain to petitioner. And, quite as plainly, payment of the debts by petitioner, if made directly by petitioner to the creditors, would not have been

[1](d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

a distribution under the statute; for that contemplates a distribution to stockholders, and not payment to creditors. If, then, petitioner had followed the simple course of retaining in its own hands the sum here in question, and subsequently paying it directly to the creditors, it necessarily would result that liability of petitioner for a tax on the amount of gain could not be avoided. And, obviously, this is the effect of what was done, although circuitously.

The money was received by petitioner and was available for the payment of its debts. It was put into the hands of the stockholders upon the express understanding, as shown by the resolution heretofore quoted, that they would assume all the corporate debts of petitioner, and would enter into a written agreement with petitioner "whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold" the corporate stock and securities which it had received in the reorganization "without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company . . ."

In pursuance of the resolution, the stockholders received the money from petitioner to the extent of $106,471.73, not as a distribution for their benefit but as a fund the equivalent of which they were bound to pass on, and did pass on, to the creditors. The conclusion is inescapable, as the court below very clearly pointed out, that by this roundabout process petitioner received the same benefit "as though it had retained that amount from distribution and applied it to the payment of such indebtedness." Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. A given result at the end of a straight path is not made a different result because reached by following a devious path. The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come to their hands, so transparently artificial that further discussion would be a needless waste of time. The relation of the stockholders to the matter was that of a mere conduit. The controlling principle will be found in *Gregory* v. *Helvering*, 293 U. S. 465, 469-470; and applying that principle here, the judgment of the court below is

Affirmed.

Mr. Justice CARDOZO took no part in the consideration or decision of this case.